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The Honorable Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

The Honorable Michael Barr
Vice Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave. NW
Washington, D.C. 20551

The Honorable Michael Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Washington, D.C. 20219

January 12, 2024

Dear Chair Gruenberg, Vice Chair Barr, and Acting Comptroller Hsu:

We are writing on behalf of the National Housing Conference (NHC) and the undersigned organizations to comment on the Notice of Proposed Rulemaking (NPR) for Amendments applicable to large banking organizations and to banking organizations with significant trading activity, or Basel III Endgame, published on July 27, 2023. Some of the undersigned organizations are also submitting separate comment letters outlining their specific concerns, in addition to the comments herein.

We appreciate the opportunity to comment on the proposed rule for joint consideration by the Office of the Comptroller of the Currency (OCC), the Federal Reserve System (the Fed), and the Federal Deposit Insurance Corporation (FDIC). While we agree that financial institutions must hold adequate capital, we are deeply concerned that this proposed rule will not have the intended effect and will be wrought with unintended consequences that will harm communities already underserved today. Our primary concern is over the treatment of mortgages and its impact on lending to first time homebuyers. We are also concerned that increasing capital across the board, without a clear connection to quantifiable risk, may undercut a broader range of community development investment and lending in underserved communities, potentially undercutting the growing use of special purpose credit programs (SPCPs) as well as the final rule for the Community Reinvestment Act (CRA).

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The significant increase in capital needed to support homeownership for higher loan-to-value (LTV) owner-occupied home mortgages will distinctly disadvantage homebuyers who do not have the benefit of multi-generational wealth or higher than average incomes, an outcome that is wholly inconsistent with the Biden Administration's overarching efforts to make housing both more affordable and more equitable.

Layering on additional standards begs the question of analytical justification for such a large increase. Banks have consistently been deemed to be well capitalized and well positioned to deal with stress.[1] The proposed rule fails to account for the reforms that have bolstered the health, safety, and soundness of the mortgage finance system over the past 15 years, reforms that resulted in a mortgage ecosystem that is vastly different than the one this regulation seems to be responding to.[2] Given these noted improvements in market fundamentals and our reasoning outlined in this letter, we urge you to maintain the agreed upon Basel III international standards rather than adopting additional stricter policies that would cause undue harm to the United States mortgage industry.

It should also be noted that the issue of mortgage credit risk was not a factor in any of the recent bank failures. The failures were caused by a lack of hedging of interest rate risk for holding long term fixed rate assets, like mortgage-backed securities and U.S. Treasuries at institutions that had extreme sensitivity to a handful of large depositors, well outside of the coverage of FDIC insurance. Additional capital would not have prevented the banks from failing.

We respectfully request that you reconsider additional capital requirements beyond the Basel III framework that may impact underserved communities. Only in cases where there is clear and compelling evidence that additional capital is required to protect consumers, should increases to the Basel III thresholds be exceeded. The proposed rule, in our view, does not provide that evidence.

The stricter credit requirements proposed in this NPR would create a distinct disincentive for banks to participate in mortgage lending by requiring additional capital to be held unnecessarily. According to the Bank Policy Institute, "The credit risk weight for balance-sheet mortgages would increase from 50% currently to as high as 90%. The add-ons for operational risk and the stress test would contribute an additional 25 percentage points to those risk weights, raising the total, all-in risk

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[1] *Federal Reserve Board releases results of Annual Bank Stress Test, which demonstrates that large banks are well positioned to weather a severe recession and continue to lend to households and businesses even during a severe recession*. Board of Governors of the Federal Reserve System. (2023, June 28).

[2] Contributor, A. B. J. G. (2023, October 14). *Fact check: Debunking seven key misconceptions in the Basel III proposal*. ABA Banking Journal.

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weight from 65%to 115%."[3] These requirements exceed what is needed to protect banks from a repeat of the Great Recession.[4] Flaws in the mortgage finance system predating the crisis have been addressed through the Dodd Frank Act.[5] The Ability-to-Repay requirements and the Qualified Mortgage rule have served to improve underwriting standards and eliminated from the marketplace the dangerous product features that contributed most directly to the '07-'08 crisis.[6] The Securities and Exchange Commission has also recently finalized a rule prohibiting conflicted securitizations. The proposed regulation ignores these changes which have made mortgage lending safer.

Compounding the shortcomings of the proposed higher capital levels is the rule's failure to give proper credit for the role of private mortgage insurance (PMI) or reinsurance, which enables affordable and sustainable mortgage credit for borrowers without large down payments and has undergone a vital transformation since the global financial crisis. In 2022 alone, private mortgage insurers helped more than 1 million households purchase or refinance a home. Sixty-two percent of these purchasers were first-time homebuyers and 34% had incomes below $75,000[7]. In the years since the last updates to U.S. bank capital standards – which recognized the value of PMI by assigning lower risk weights on covered loans – private mortgage insurers have implemented a number of important changes that have enhanced the industry's ability to serve as a source of strength and reliability in the housing finance system, through all economic cycles.

The Federal Housing Finance Agency (FHFA), to ensure that PMIs are well positioned to serve as a permanent, dedicated source of first loss credit risk protection to the market, and to manage counterparty risk to the Enterprises, has twice enhanced Private Mortgage Insurer Eligibility Requirements ("PMIERs"), boosting PMI industry capital and creating a more rigorous standard than those of state regulators. They also oversaw the updating of master policies to reduce rescission risk, and encouraged the evolution of business models from ones in which credit risk is largely accumulated on balance sheets, to one in which risk is distributed to a broader set of investors, providing for a more resilient, through-the-cycle approach to capital and risk management. As of Q3 2023, private MIs held 69% more regulatory capital than required under PMIERs.[8] This proposal ignores these improvements and the loss-

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[3] Paul Calem and Francisco Covas (2023, October 13). The Basel proposal: What it means for mortgage lending. Bank Policy Institute.

[4] Goodman, L., & Zhu, J. (2023, September). *Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios.*

[5] Kaul, K., & Goodman, L. (2018, August). *What, if anything, should replace the QM GSE patch?*

[6] Kaul, K., & Goodman, L. (2018, August). *What, if anything, should replace the QM GSE patch?* https://www.urban.org/sites/default/files/publication/98949/2018_10_30_qualified_mortgage_rule_finalizedv2.pdf

[7] GSE Aggregate Data.

[8] Q3 2023 Private Mortgage Insurer 10-Q Filings.

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absorbing value of PMI in its treatment of risk weights.[9] By way of contrast, the risk weighting under the proposal is more than three times the FHFA's risk weighting for >90 LTV loans in its January 2023 revision of the Government-Sponsored Enterprises (GSEs) Single-Family Pricing Framework that decreased the fees for creditworthy borrowers who have smaller downpayments but also pay for PMI.[10] The FHFA conducted a rigorous analysis of its risk-based capital framework for the GSEs that resulted in data driven relative risk weights for mortgages.[11] There is now a wide gap between the risk weights determined by this proposal and FHFA's, which recognized the importance of PMI in its analysis. This difference between the regulatory capital structures creates a capital arbitrage. Since 2015, PMI has transferred more than $68.2 billion in risk to investors, and high LTV GSE loans with PMI experienced 11% less in losses than lower LTV loans without PMI.[12] In short, private mortgage insurance is a stronger risk mitigant today than it was when the last round of capital rules were ratified, and should therefore be recognized in any new rules.

Bank participation in mortgage lending fills a market gap for mortgages for low- and moderate-income (LMI) borrowers that otherwise would not qualify for loans that traditionally serve that market, such as loans backed by the GSEs, the Federal Housing Administration, or the Department of Veterans Affairs (VA).[13] Consumers may not qualify for those loans for any number of reasons, but still be ready for homeownership. Should banks retreat from the mortgage market, mortgages serving LMI borrowers will be further sequestered into government-backed loans and concentrated in the sector along with Independent Mortgage Banks (IMBs). This resulting concentration decreases market diversity and lessens the market options for LMI borrowers. The U.S. mortgage market is best served by a diverse set of lenders and servicers with different business models and funding sources. Dependency on any single funding or servicing source makes the market as a whole more fragile during periods of stress.

The NPR seems to suggest that holding this additional capital against residential mortgage exposures will bolster a bank's ability to lend, suggesting that more capital would result in more lending. This logic is flawed. Instead, the increase in capital would impact decision making by banks on which business lines they participate in or withdraw from, likely reducing banks' participation as single-family and

[9] Statement of Seth D. Appleton, President of U.S. Mortgage Insurers before the United States House of Representatives Committee on Financial Services, Subcommittee on Housing and Insurance. December 6, 2023.

[10] Federal Housing Finance Agency. (2023, May). *Fannie Mae and Freddie Mac single-family mortgage pricing framework RFI.*

[11] Federal Housing Finance Agency. (n.d.). *Enterprise Regulatory Capital Framework – Public Disclosures for the Standardized Approach.* Enterprise Regulatory Capital Framework Final Rule.

[12] Urban Institute. (2023b, May). Housing Finance at a Glance: A Monthly Chartbook.

[13] Goodman, L., & Zhu, J. (2023, September). *Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios.*

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commercial/multifamily lenders, servicers, and as providers of warehouse lines of credit and financiers of mortgage servicing rights (MSRs).[14] The market is already seeing an exit of bank activity from the mortgage market. Banks now account for 28% of all mortgage-loan originations for home purchases, while between 1995 and 2007 they accounted for as much as 70%.[15] There is little justification for adding additional incentives for this trend to continue.

It is imperative that the agencies also recognize the downstream impacts of these additional capital standards on the overall housing and mortgage market, including IMBs, affordable housing developers, community developers, community banks, and other industry stakeholders. We appreciate that the proposal maintains the current risk weights for multifamily mortgages. There remains a persistent need for more housing units, particularly affordable housing units, that can only be met by purposeful efforts to increase supply. Despite the risk weight for multifamily mortgages being maintained, we are concerned that changes to acquisition, development, and construction lending might impact multifamily development, which is already seeing reduced interest given the current rate environment.[16] To help address the affordable housing supply deficit, we also urge the regulators to apply a lower risk weighting of 50% to Low-Income Housing Tax Credit (LIHTC) properties, our nation's primary tool for financing the development and preservation of affordable housing. This threshold is consistent with what is available to statutory multifamily mortgages, more accurately reflects the risks of LIHTC investment, and would support investment in affordable housing at a time of staggering need.

Mortgage servicing remains the core of housing finance sustainability, which ultimately helps keep people in their homes. A mortgage servicing asset (or right) is created when the originating lender sells a mortgage but retains the right to service the loan and collect a servicing fee that is part of the note rate. Banks create MSRs when they sell loans they have originated (or purchased) in the secondary market; they can also acquire MSRs from other servicers. Any regulatory discouragement of servicing sends a concerning signal to banks that is counter to the progress made since the Great Recession. This proposal reimposes a 10% cap on the amount of MSRs that can count toward a large bank's tier one common equity. Banks must maintain punitive dollar-for-dollar capital on the value of MSRs that exceed the 10% cap.

Importantly, in addition to collecting payments and passing them through to investors, servicing activities involve critical home retention and loss mitigation functions, communicating the options to the borrower if they fall behind on their

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[14] *Testimony of the Mortgage Bankers Association House Financial Services Committee, Subcommittee on Financial Institutions and Monetary Policy*. (2023).

[15] Anton, A. (2023, September 14). *BPI's Greg Baer testifies on Basel Endgame Before House Financial Services Subcommittee*. Bank Policy Institute.

[16] Mortgage Bankers Association. (2023, November 7). *Commercial/multifamily borrowing down 49% in third quarter*. MBA Newslink.

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payments. Lowering the MSR cap to 10% could lead to diminished MSR demand, liquidity, and valuations, and consequentially higher borrower interest rates.[17] Banks have already significantly retreated from the mortgage servicing business in response to the 2013 changes to Basel that sharply increased capital requirements on MSRs by imposing a 250% risk weight and the 10% cap. This led to a rapid spike in the share of the mortgage servicing market held by nondepository institutions.[18] As banks predicted at the time and the Bank Policy Institute has demonstrated, when bank regulators subsequently increased the cap to 25% for all but the largest banks, bank participation in mortgage servicing increased but that of the largest banks still covered by the 10% cap did not.[19] By extending the punitive treatment of mortgage servicing to even more banks as proposed in Basel III Endgame, more of this activity will shift outside of the banking system to nonbanks. Reducing the market for this important asset reduces its liquidity, thereby further increasing liquidity risk for nonbanks and adding to the asset's price volatility. It has been demonstrated that banks will shift away from those markets where capital rules assess sharply higher requirements than the underlying risk warrants.

This reduction of appetite from banks will push more market share into IMBs and other originators. The issue is concentrated further by the fact that the proposal makes it more difficult for IMBs to support the mortgage market through impacts on both MSRs and warehouse lines of credit. According to an analysis from the Urban Institute, mortgage servicing rights are the dominant asset for most IMBs and warehouse lending is the dominant source of liquidity. "When an IMB steps in to maintain the payments owed to mortgage-backed securities investors as borrowers fall behind—a role critical to the functioning of the mortgage market—they look to warehouse lenders for the needed short-term funding, putting up their MSRs as collateral. Warehouse lending is also important to IMBs' mortgage lending, providing them the funding to cover the period between a loan's origination and its securitization," the analysis stresses.[20]

When mortgage markets experience stress and borrowers struggle to make their payments, as often coincides with any national economic downturns, IMBs will need to rely on banks for funding to keep the market functioning. Buyers of MSRs would soon become sellers under this reduced cap, driving down the value of the primary asset of IMBs. We urge the regulators to maintain the current 25% cap to avoid this strain on both MSRs and warehouse lending for IMBs that could further stress the

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[17] Statement of Robert D. Broeksmit, CMB President and CEO, Mortgage Bankers Association before the U.S. House of Representatives House Financial Services Committee, Subcommittee on Financial Institutions and Monetary Policy Hearing Entitled: Regulatory Partisanship: Basel III Endgame September 14,2023.

[18] Goodman, L., & Lee, P. (2014, March 31). Oasis: A securitization born from MSR transfers.

[19] Freedman, A., Covas, F., & Dionis, G. F. (2020, December 18). *The impact of recent changes in capital requirements on mortgage servicing assets*. Bank Policy Institute.

[20] Bank Regulators Are Taking Too Narrow a View of Mortgage Risk, by Jim Parrott and Laurie Goodman, Urban Wire, September 18, 2023

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market and create unnecessary liquidity pressures. Moreover, this shift will further concentrate more of the market share with IMBs, creating additional imbalances in contradiction to the goal of the regulations.

Under the proposal, there is further concern regarding assigned risk weights to mortgage warehouse lines of credit, which cover the period between the origination of a loan by an IMB and its subsequent sale or securitization in the secondary market. The proposed rule – without explanation – increases the "credit conversion factor" on warehouse lines of credit – effectively doubling the amount of capital that must be retained against the undrawn portion of the line. The higher capital requirements do not correlate with the actual risks associated with the underlying mortgage loans backed by the lines, and could raise the costs or discourage banks from offering them altogether.[21]

The Biden Administration has been steadfast in its commitment to addressing housing supply and the affordability crisis across multiple agency efforts, clarification of the legality of use of SPCPs, and its Housing Supply Action Plan. If implemented, the additional credit requirements on top of new international standards dampen the important impacts of these policies and create a distinct misalignment that ultimately undercuts the progress that is being made.

Regulators should also note the irony of enacting capital requirements that undercut these broader efforts after just finalizing CRA regulations meant to address lending inequities across the U.S. Throughout November 2023, each agency lauded the efforts and results of their interagency modernization of the rule, and the purposeful focus of smoothing out federal support for lending efforts in underserved communities.[22] The Basel III Endgame changes inexplicably tell banks that under CRA, banks are expected to operate in these areas, but simultaneously under Basel the agencies are discouraging any products designed for the very members of those communities.

The proposed rule would have a disparate impact on Black and Latino borrowers.[23] High-LTV mortgages are particularly important for first-time borrowers, especially borrowers of color who may have lower wealth due to centuries of discriminatory housing policies. Analysis shows that the racial/ethnic distribution of income groups continues to disproportionately advantage White households. The homeownership rate for White households making 80% and below area median income is 58%, while

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[21] Statement of Robert D. Broeksmit, CMB President and CEO, Mortgage Bankers Association before the U.S. House of Representatives House Financial Services Committee, Subcommittee on Financial Institutions and Monetary Policy Hearing Entitled: Regulatory Partisanship: Basel III Endgame September 14,2023.

[22] National Housing Conference. (2023). *Breakfast with Barr: A conversation about CRA in the 21st century*. Retrieved January 5, 2024, from https://nhc.org/event/breakfast-with-barr-a-conversation-about-cra-in-the-21st-century/ .

[23] Laurie Goodman, Jun Zhu, *Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios*, Urban Institute (Sept. 2023).

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that number is only 30% for Black households, 36% for Latino households, and 45% for Asian households.[24]

In fact, the Urban Institute's research shows that 27% of all purchase loans and 26% of conforming loans made to Black and Latino borrowers had high LTV ratios, compared with 19% of all bank loans.[25] It is unclear why the Agencies would issue this proposed rule when these same agencies recently joined guidance encouraging lenders to originate SPCPs,[26] which were designed to overcome the discriminatory policies that have created wide and persistent homeownership and wealth gaps.

There is further argument that such a sliding scale based on factors that coincide with lending to Black and Latino borrowers is sufficient to constitute a fair housing violation. Under the Fair Housing Act, federal regulatory agencies are required to assess policy changes for their potential to discriminate against or exacerbate negative outcomes for protected classes under the Act. Rather than affirmatively further fair housing, this approach may negatively impact homeownership opportunities for all protected classes. A fair lending analysis must be conducted prior to enactment in order to prevent any Fair Housing Act concerns of pushing consumers into forced choices.

Outside of mortgage markets alone, the rule would likely impact lending in the rural space where CRA-driven investment could be reduced. Raising capital standards discourages lending and reduces credit availability through downstream impacts, which will likely be felt first and foremost by lower income businesses and underserved groups who are often overrepresented as borrowers with riskier loans. This means that an LMI small business owner who previously could have been funded through CRA-driven investment may not see that investment because community development initiatives under CRA will be stressed or negated. Given how recently the CRA regulation was updated and the impending two-year implementation period that will shift the lending dynamics of banks, it is particularly risky to make additional changes while a new market equilibrium is being tested.

Such a significant increase in capital standards under the Basel III Endgame proposal will lead to reduced credit availability for all types of real estate buyers and undermine economic growth. Worse, if these standards are adopted, they will have a devastating impact on our efforts to increase homeownership in communities of color and

[24] *See id.*

[25] *See id.*

[26] Federal Reserve Board, FDIC, OCC, National Credit Union Administration, Consumer Financial Protection Bureau, Department of Housing and Urban Development, Department of Justice, Federal Housing Finance Agency, *Interagency Statement on Special Purpose Credit Programs under the Equal Credit Opportunity Act and Regulation B* (Feb. 22, 2022).

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disadvantage all LMI, first-time, and, in particular, first-generation homebuyers of all races who do not have the benefit of multi-generational wealth or higher than average incomes. We as an industry share these common concerns should the stricter capital standards be applied on top of Basel III, and urge the regulators to reconsider these standards before they further harm the housing market.

Respectfully,

National Housing Conference
AmeriHome Mortgage
Bank Policy Institute
Eden Housing
Enact Holdings, Inc.
Faith And Community Empowerment (FACE)
Guild Mortgage
Habitat for Humanity International
Homeownership Council of America
Local Initiatives Support Corporation (LISC)
Low Income Investment Fund
Manufactured Housing Institute
Mortgage Bankers Association
NAACP
National Affordable Housing Management Association
National Association of Home Builders of the United States
National Association of REALTORS®
National Community Stabilization Trust (NCST)
National Multifamily Housing Council
National Council of State Housing Agencies
National Urban League
New American Funding
Pulte Financial Services
ROC USA
UnidosUS
U.S. Mortgage Insurers
Western Alliance Bank